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STATE PASS DOE FOR DAS JBRODMAN AND CGAY
STATE PASS TREASURY FOR ASEVERENS AND SRENENDER
STATE PASS DOC FOR KBURRESS
STATE PASS TRANSPORTATION FOR MARAD
STATE PASS OPIC FOR ZHAN AND MSTUCKART
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STATE PASS USAID FOR GWEYNAND AND SLAWAETZ

E.O. 12958: DECL: 08/25/2015
TAGS: EPET PGOV NI
SUBJECT: NIGERIA TO CONCLUDE 2005 BID ROUND FOR 88 BLOCKS; MAJORS CONCERNED WITH TIGHT FISCAL TERMS, BUT DEEPWATER CONTINUES TO GENERATE SIGNIFICANT INTERNATIONAL INTEREST

Classified By: Consul General Brian L. Browne for Reasons 1.4 (D & E)

Summary

¶1. (C) On August 26, Nigeria will hold a bid round for 88 oil blocks. Bidders will be judged on both commercial and technical bids in a Brazilian style competitive process. Changes to the Deep Offshore fiscal regime include the introduction of a royalty as well as an 80 percent cost recovery cap. GON has received 379 bids from about 278 companies for the blocks on offer. U.S. majors operating in Nigeria will participate in the bid round, but their enthusiasm is considerably diminished by tightened fiscal terms. However, several U.S. independents seem pleased with the blocks on offer, and are willing to consider the diminished fiscal terms. Significant interest is also expected from new entrants from China, India, and Korea. Some of them will receive preferential access in exchange for commitments to construct refineries or independent power plants in Nigeria,s beleaguered downstream sector.

61 Blocks Up for Bid in 2005 Round; More may be Added Later

¶2. (U) A total of 88 exploration and production blocks, will be offered during the 2005 bid round. These include the last of the deepwater blocks in exclusively Nigerian waters. Some of the blocks, with Ministry of Petroleum Resources estimates of their prospectivity are listed below:

--12 Deep Offshore (High)
--6 On the Niger Delta Continental Shelf (High-Moderate)
--6 On-Shore in the Niger Delta (High-Moderate)
--9 In the Anambra Basin (Moderate-Low)
--16 In the Benue Trough (Low)
--12 In the Chad Basin (Low)

GON Pleased with Level of Interest in the Bid Round

¶3. (U) Department of Petroleum Resources (DPR) Director Tony Chukwueke told us the GON is pleased with the level of interest in the bid round. GON has received 379 bids from about 278 companies. He noted keen interest in blocks 321 and 323, with blocks 257, 215, and 214 also generating significant attention.

¶4. (U) The Bida and Sokoto basins are not included in the bid round, because technical specification data is unavailable. Up to 20 additional blocks in the Niger Delta may become available, once pending legal issues are resolved. Full details on all blocks currently on offer will be available at the 2005 Bid Round website. Relevant technical data including seismic, well, gravity, topographical, satellite photo, maps, geological and geophysical studies will be available to bidders according to MPR.

GON's Goals for the 2005 Bid Round

¶5. (U) MPR's goals for the round include:
-- Pursuing and realizing national production targets and the oil reserve base to support them. (Note: The GON hopes to double its production of approximately 2.4 million

barrels/day by 2010.);
--Expanding opportunities for gas development;
--Attracting new international players, while continuing to encourage traditional players;
--Attempting to reverse the migration of oil and gas exploration from the Delta towards the deepwater;
--Providing an opportunity for strategic downstream projects to attract investors by giving such investors preferential treatment of upstream projects;
--Implementing a viable and comprehensive Local Content strategy; and
--Using the opportunity of the 2005 bid round to reinforce Nigeria's commitment to transparency and the principles of EITI.

Changes in Commercial Measures
Alter Fiscal Regime in Favor of GON

¶6. (SBU) The introduction of a royalty element and a ceiling on oil cost recovery are designed to increase GON's revenues in the early years of PSC projects; hitherto, the operator took all the revenue for several years to recapture capital investment expenditures. The MPR recognizes international best practice for attaining maximum well like and optimal production is for government to take its share of project revenues after first oil and full cost recovery. Dr. Edmund Daukoru, Minister of State for Petroleum Resources, acknowledges the royalty payments violate these principles, and can "kill wells" prematurely. However, the GON finds itself constrained by the exigency of current budget demands base; over 80 percent of GON revenues flow from the petroleum sector and any appreciable dip in these revenues immediately diminish the governments fiscal strength. As the first generation of PSC projects (e.g., Bonga, Ehra, and Agbami) come on-line, the GON will face low revenue flows on these projects for several years while the operators recover costs. The GON is determined not to find itself in the same fiscal bind with the new blocks up for bid in 2005. Dr. Daukoru also argues the Nigerian deepwater is no longer frontier territory, and future projects do not merit the same investor incentives as the high-risk early projects.

MPR Will Follow Brazilian Local content Model;
Using Pre-Qualification to Avoid Speculators
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¶7. (U) The MPR has examined a number of national models for development of local content, such as those used by the UK and Norway to develop their petroleum sector. However, the MPR Believes the Brazilian system most applicable to Nigeria. Recently a MPR team including Dr. Daukoru, traveled to Brazil to learn more about their local content efforts. Through pre-qualification of national firms, the MPR sought to avoid the "hawking of Nigerian assets overseas" by Nigerian companies selling acreage to foreign concerns, it believes occurred in past bid rounds. This is just one change instituted as a result of their study of the Brazilian model. In past years, the GON found that some indigenous firms had received rights to develop acreage which they had neither the skills nor intention to develop, but only the desire to sell for a quick profit. The MPR designed the qualification system to make sure indigenous firms had the requisite technical, financial, and managerial competence, prior to being admitted to participate in the bid round with a foreign partner.

Local Content Vehicles

¶8. (U) In its quest to increase the level of national content in the petroleum industry, the GON has mandated that all bidders take on a minority technical partner. After an evaluation of their competency and work histories, the DPR pre-qualified a number of firms to participate as &local content vehicles,8 (LCVs). LCVs can acquire up to a 10% stake in a project. DPR Director Tony Chukwueke admits not all firms will be able to obtain 10 percent of the equity for their project, and he expects some firms will be &carried8 financially by their foreign partners. Conoil, a large presence in the downstream sector, and well represented in the Nigerian petrol station market, is the lone indigenous firm which qualified to participate in the bid round as a full bidder in its own right, and not as a LCV minority partner.

¶9. (SBU) The screening and approval LCVs has been problematic. Finally, with less than a month left before the bid round, DPR released a list of pre-qualified LCVs to prospective bidders. DPR and Ministry of Petroleum Resources have been encouraging a number of the &one man shops8 to merge, in order to meet the technical and financial needs of their foreign partners. While majors continue to complain about the low technical and financial capability of the LCVs, most majors appear committed to working with the current

situation.

Majors, Large Independents Dubious about Bid Round;
ExxonMobil Expects its Bid may Disappoint GON
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¶10. (C) Ian Fischer, General Manager Exploration for Esso, ExxonMobil Nigeria,s deepwater subsidiary, speaking of the deepwater blocks on offer, &There were enormous expectations, but we don't see the prospectivity, and the (fiscal) terms are worse.8 To underscore EM,s concerns regarding fiscal terms, Fischer shared an EM document, which showed the total government &take8 from the blocks auctioned under 1993 fiscal terms was 43% of the revenue; under 2003 62% of the revenue; and under the 2005 fiscal terms, 70% of the revenue. He explained the proposed &take8 in this round was too high, given that under the terms of Nigeria,s production sharing contract, the majors assume the sole risk for billions in exploration and development costs for deepwater.

¶11. (C) Fischer elaborated on the poor prospectivity, noting most deepwater blocks in Nigeria currently under exploration were on the &inner shelf,8 along a contour in about 2000 meter of water. Some of the blocks in the current bid round (and in last fall,s Joint Development Zone bid round) are in the &outer shelf,8 in about 3000 meters of water. Fischer stated that, &Most wells in the outer bank have so far been a disappointment.8 While noting both EM and rival firms are loath to advertise their failures, he believed about six wells in the outer shelf had come up &dry.8

¶12. (C) Based on EM,s assessment the blocks on offer may have poor prospectivity along with tough fiscal terms, Fischer anticipates the GON may well be disappointed with EM,s participation in the bid round, as "there is an expectation ExxonMobil will be in full force for the bid round.8 He added Government,s minimum bid of $50 million per block was &a problem,8 noting firms might have been willing to submit low, non-conforming bids for certain blocks, but now appeared to be prevented from doing so.

Chevron Echoes Pessimism re: Bid Round

¶13. (C) Chevron Nigeria Planning Manager Kevin Lyon stated that Chevron would likely only bid on 2 blocks, both of which would leverage existing Chevron assets in neighboring blocks. He too indicated tightened fiscal terms were a significant deterrent to Chevron,s fuller participation. Lyon continually stresses the stiff competition within Chevron for investment capital; Nigerian projects compete with projects from around the world for funding. With returns in Nigeria ranking near the bottom for Chevron,s worldwide operations, the firm is making the decision to allocate scarce investment capital elsewhere. (Comment: Industry interlocutors consistently indicate in this era of record-high oil prices, the additional economic rent from these revenues completely accrues to the GON, creating a disincentive to invest in Nigeria at this time. For example, the industry can currently earn much higher returns of U.S.-based projects in the Gulf of Mexico, where returns are among the highest in the world. End comment.)

Independents Weigh In with Negative Views on Round
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¶14. (C) The larger independent firms appear to share similar views about the bid round. Devon Energy Nigeria Managing Director (MD) Raymond Marchand stated they were still &running its numbers8 for the bid round during our last conversation, but his analysis regarding the Devon,s participation was decidedly pessimistic. MD of Canadian firm Nexen, Richard Owens, shared a similarly negative assessment.

New Entrants Seem More Enthusiastic

¶15. (C) However, there are a number of new American firms entering the Nigerian market for the first time in this bid round. While cautious, they appear more optimistic about the prospects for Nigerian deepwater than do the established players. In recent months, the mission has hosted a series of visitors from U.S. independents Occidental and Amerada Hess. Amerada Hess, for example, is showing some caution by entering Nigeria initially as a non-operating partner, but both firms are upbeat about the commercial potential of the blocks on offer. U.S. independent Pioneer is also apparently planning to bid, but has not engaged the mission in its trips to Nigeria.

Nigeria Moves onto the World Stage;
Chinese Firms, Other New Entrants Participate Vigorously
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¶16. (C) The Ministry of Petroleum Resources seems to view this bid round as Nigeria,s move onto the world stage. Seeking to broaden the Nigerian market beyond the traditional &Big 58 (Shell, Chevron, ExxonMobil, ENI/AGIP, and Total) by which Nigeria has often felt itself dominated, the GON has worked hard to attract interest from both new countries and new entrants, including U.S. independents not yet represented in Nigeria. The bid round road show traveled to London, Houston, and Singapore to attract international participation. The Ministry of Petroleum Resources believes its efforts have been worth it: they expect 4-5 Chinese firms to bid, as well as a firm from India. The Korean National Oil Company will also bid. Several U.S. independents will also participate. (Comment: Unfortunately for U.S. firms, it appears from press reports the Chinese firms may well have secured preferential access to certain blocks, based on their parastatal firms, commitments to the GON to finance the downstream sector projects (refineries and independent power plants). China, concerned with its long-term energy security, appears to be willing to underwrite potentially unprofitable downstream investments to secure strategic access to upstream blocks. U.S. firms, concerned with the profitability of the still price-regulated Nigerian downstream, are incapable of making such commitments. End comment.)

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